

ROUTING AND RECORD SHEET

SUBJECT: (Optional)

Soviet Financial Balance Sheet

FROM:

D/SOVA
4E58
Hqs.

EXTENSION

NO.

DATE

19 July 1988

STAT

TO: (Officer designation, room number, and building)

DATE

OFFICER'S INITIALS

COMMENTS (Number each comment to show from whom to whom. Draw a line across column after each comment.)

RECEIVED

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21 JUL 1988

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21 July

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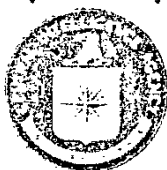
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DCI
EXEC
REG



Central Intelligence Agency
Office of the Deputy Director for Intelligence

20 JUL 1988

NOTE TO: Deputy Director of Central Intelligence

SUBJECT: Soviet Financial Balance Sheet

SOVA tells me that the lack of alternative views in the letter prepared for your signature reflects a true consensus within this building on the issues raised by Armitage. I wouldn't be surprised, moreover, to find that Armitage is unaware of the body of existing work in this area.

While Armitage may have his numbers wrong, he is right on the mark in terms of the need to keep close tabs on the opportunities Soviet economic difficulties may present for the United States. SOVA has a number of papers listed in next year's research program which are pertinent to this issue.



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Richard J. Kerr

Deputy Director for Intelligence

*The response was coordinated
with WIOs and OGI
JK*

Central Intelligence Agency



Washington, D.C. 20505

21 JUL 1988

O/PPI Reg
02553X/88

MEMORANDUM FOR: The Honorable Richard L. Armitage
Assistant Secretary of Defense for
International Security Affairs

SUBJECT: Soviet Financial Balance Sheet

REFERENCE: Your Memo to DDCI, dtd 2 July 88, Same
Subject

1. Gorbachev's difficulties in revitalizing his domestic economy--as you clearly point out--have potentially significant ramifications for Soviet foreign policy with both the developed West and its surrogates in the Third World. It remains to be seen, however, whether Moscow is willing to turn to the West for assistance. There are numerous accounts of an intense ongoing debate on this very issue, with opponents of expanding reliance on the West citing the poor results from past buying sprees and the need to avoid giving the West the very "leverage" you point out in your 2 July letter. [redacted]

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2. The Office of Soviet Analysis has allocated substantial resources to examining Soviet trade and financial flows and plans to do even more over the next several months. In particular, I would draw your attention to the evidence and analytical argument presented in the four attached assessments. Based on this body of work and subsequently available evidence it is our view that:

--The leadership has heretofore sought an indigenous solution to its economic problems but may well decide to turn to the West for the technology, equipment, and consumer goods needed to get its modernization program on track. We are in a strong position to monitor both the flow of goods and services and financial initiatives which make these purchases possible.

~~Regrade to Confidential No form when~~
~~Secret attachments are removed.~~

~~SECRET~~

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SUBJECT: Soviet Financial Balance Sheet

--Moscow has the ability to increase substantially its hard currency indebtedness without threatening its fundamentally strong balance of payments position or otherwise leveraging itself to the West. []

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3. The Soviets have clearly taken a harder line with their Third-World clients on the terms for Soviet economic and, in some cases, military assistance. Only a portion of these flows, however, involve hard currency; specifically we have yet to see evidence that hard currency constraints are forcing Moscow to make hard choices regarding active measures campaigns, clandestine technology acquisition, overseas KGB activities, and the like. We have levied additional collection requirements and undertaken additional analyses to get a better handle on these activities but this type of information understandably remains hard to obtain. []

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4. We are confident, moreover, that the annual overall hard currency cost of Soviet foreign involvements is less than \$3 billion as opposed to the \$15-20 billion cited by Rand:

--The Rand estimate of \$15 billion--last made in 1983--includes nearly \$12 billion in "trade subsidies" based on the below market fuel prices charged to Soviet clients and the premium prices Moscow paid for imports such as Cuban sugar. Although the hard currency opportunity costs are relevant, this subsidy "cost" is fundamentally different from the cash outlays cited above. Moreover, this "subsidy" has turned into a "tax" because the price Moscow now charges its clients for oil is above rather than below world market prices.

--The balance of Rand's \$15 billion "burden" estimate is comprised of Soviet arms deliveries which do not require payment in hard currency. We do not agree that such deliveries equate to a hard currency "burden" as there is no evidence that Moscow has lost out on hard currency arms sales by virtue of its sales and gifts of arms to soft currency clients. Our own analysis shows Moscow taking a tougher line with some of its clients over payments for arms deliveries but, at the same time, increasing the grant element in some of its contracts and offering easier credit terms in order to boost sales.

SUBJECT: Soviet Financial Balance Sheet

--Our annual balance of payments estimates consistently show errors and omissions averaging less than \$4 billion which we believe incorporate hard currency expenditures for overseas activities. This order of magnitude seems reasonable when one considers that the US budget for 1986 lists US expenditures on the conduct of foreign affairs and foreign information and exchange at \$3.3 billion. Given Moscow's more austere approach to funding its foreign missions abroad, the soft nature of Soviet expenditures in much of the Third World, and our confidence in the ability to track aggregate Soviet foreign exchange flows, we are comfortable in the judgment that actual Soviet hard currency outlays are in the \$3 billion range. [redacted]

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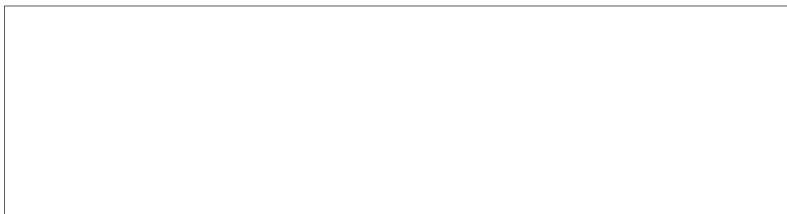
5. This evidence leads us to conclude that hard currency "shortages" have yet to affect substantially Soviet behavior. Soviet intransigence on the Northern Territories, for example, demonstrates that non-economic issues continue to play a key role in foreign policy decisions. A desire to achieve a more benign world environment and otherwise improve the atmosphere for expanded trade and technology flows clearly plays an important part in Gorbachev's foreign policy strategy. At the same time, one should not overlook the more general impact of perestroika on Soviet foreign policy thinking and decisionmaking. Only time will allow us to sort out the economic variables in this equation. [redacted]

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/s/ Bob

Robert M. Gates
Deputy Director of Central Intelligence

Attachments:



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SUBJECT: Soviet Financial Balance Sheet

DDI/SOVA [redacted] (19 Jul 88)

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